1:Stanford U. S-4, 5 1956 AF14 Central China AF14

Economic Background

BUDGET AND TAXATION

I. THE NATIONAL FISCAL SYSTEM

652 •

Since Communist China is a unitary state, its fiscal policy is national in scope and has relatively few regional variations Accordingly, unless otherwise indicated, what is said here of one region is often equally true in the other regions.

From the data shown in the tabulation below, certain facts are obvious.

1. During 1950-54, the revenue derived from the profit of government enterprises rose steadily from 12.76 per cent of the total government receipt in 1950 to 36.47 per cent in 1954. Moreover, profit is not the only contribution that government enterprises made to the government treasury. In the course of these years, they also contributed an increasingly large share of taxes which the People's Republic of China (the Communist government) imposed upon industries and trade. This tendency is clearly shown in the following statistics.

[See following page for chart.]

1:Stanford U. S-4,5 1956 AF14 Central China AF14

SOURCES OF GOVERNMENT RECEIPTS */

Year	Government-owned Enterprises	Government-Participating Enterprises	Co-operatives	Farmers	Private Industries and Trade
			(combined)		
1950	-	-	34.08 -	29.63	32.93
1951	-	-	49.35 -	18.17	28.66
1952	-	-	56.33 -	17.08	22.36
1953	-	-	59.79 -	14.56	17.02
1954	65.24	3.65	1.66	14.23	13.34
1955	69.47	3.65	1.98	11.76	10.70

*/ In percentage of the total annual receipt of the current year. Economic Weekly, February 26, 1953, p. 17; People's Daily, June 18, 1954; July 10, 1955.

Unlike the usual concept used in Western countries, the profits of government-owned concerns and enterprises in which the government participates as listed in fiscal reports

652

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

of the Communist government include allowances for depreciation of assets, which according to the Western practice should not be included in net profit. At the same time, all the outlays of government enterprises for improvement and replacement are listed as government expenditures for economic construction. The procedure used by the Chinese Communists means therefore a substantial increase in both government receipts from its enterprises and outlays for economic construction.

2. During the five-year period ending 1954, the relative importance of the agricultural tax has been substantially reduced. In 1950, it accounted for 28.01 per cent of the total government expenditure. In 1954, the percentage declined to 13.33 per cent. The decrease was due to the rapid expansion of receipts from other sources (particularly profits from government enterprises and urban taxes) rather than to the reduction in the agricultural tax itself. This development therefore should be interpreted to mean that the tax on rural economy has not been reduced; it reflects merely that the increase of the agricultural tax has not been as rapid as the increase of other government receipts.

3. Similarly, the fact that the ratio of the taxes on industry and trade to the total government expenditure remained almost constant during these years should not be interpreted to mean a constant tax burden imposed on these sectors of the Chinese economy. In absolute terms, their contributions have continually increased in order to meet the ever-expanding expenditure of the government.

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As a whole, the fiscal policy of the Communist government has been more unfavorable to industry and trade than to agriculture. During the five-year period under consideration, private enterprise in industry and trade not only has had to bear a great burden of the increasing expenditure of government, but also has been forced to accept stiff competition from government enterprises, which, according to Communist policy, will ultimately monpolize all the important trade and industries in the country.

On the expenditure side, military outlay constituted 41.5 per cent of total government expenditure in 1950 and 1951, respectively. Since 1952, because of the truce in Korea, the relative importance of the military outlay has been substantially reduced. In 1954, it was only 21.1 per cent of the year's total expenditure. The outlay for economic construction has become the leading item on the debit side of the government account.

In making these comparisons, several observations should be noted. First, the military expenditures as listed in the records of the Communist government do not include salaries and maintenance of military personnel, which are classified as government administrative expenses. Military outlays listed in the budgets of the Nationalist Government, on the other hand, consisted mainly of such salary and maintenance payments. If the definition of military expenditure were broadened to include such outlays, and if one-half of the administrative expenses listed in the Communist budget were for the payment of military personnel and administration, then the military expenditure of the Communist government for the years 1950-52 would have been as tabulated here:

Year	Ratio of Military Expenditures to Total Government Expenditures (In per cent)	
1950.	51.11	
1951.	49.83	
1952.	32.15	
1953.	29.45	(budget estimate)
1954.	30.06	
1955.	32.98	(budget estimate)

In the fiscal report for 1953 the military and government administration expenditures were lumped together under one item. It is rather difficult to separate the military from the non-military outlays on the basis mentioned above. For this reason, the budgetary estimates, where these outlays were separately listed, were used in this tabulation.

652
659

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652 659

A second point which should be noted concerning the military expenditure of the Communist government is that a part of its expenditure for economic construction might well be considered military rather than economic. In the budget of the Nationalist Government, for example, outlays for developing aircraft-manufacturing industries, ammunition industries, and so forth were usually classified as military expenses, whereas they would probably be considered as economic outlays in the Communists' report.

652

A third point to be noted is that, if the depreciation charges and outlays for maintenance and replacement in government enterprises were excluded from government receipt and expenditure, as should normally be the case. the relative importance of military expenditure for the years under consideration would have been much greater than those shown in the fiscal reports.

Even allowing for these adjustments, the fact that government outlays for economic, social, and educational purposes has been substantially increased under the Communist regime is obvious when compared with the conditions under the Nationalist government. Whether these expenditures have actually contributed to improving the economic and social welfare of the people is, of course, another question entirely.

1:Stanford U. S-4,5 1956 AF14 Central China AF14

EXPENDITURE AND RECEIPTS OF THE PEOPLE S REPUBLIC OF CHINA *

	1950	1951	1952	1953	1954
Expenditures					
Military	41.50	42.52	26.23	-	24.19
Government Administration	19.21	14.71	11.83	44.62	11.74
Other	2.64	2.01	3.49	-	-
Economic construction	25.51	29.50	44.79	40.38	52.07
Cultural Construction	11.11	11.26	13.66	15.00	12.00
Receipts					
Agricultural tax	28.01	18.24	15.69	14.90	13.33
Taxes on industry and commerce	43.84	49.16	42.28	43.43	36.46
Receipts from govt. enterprises	12.76	25.64	28.55	35.40	40.49
Income from credit and insurance	4.87	4.79	1.53	3.00	1.26
Other	-	-	-	14.41	-

652

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652

* In percentage of total government expenditure. Compiled on the basis of actual government outlays and receipts as in fiscal reports of the People's Republic of China.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652

In the discussion that follows, we shall examine at length some phases of Communist China's fiscal policy during the first five years of occupation of Mainland China. They include the agricultural tax the taxation on commerce and industry, and government bonds. As will be seen, the revenues discussed are all recurrent in nature. No attempt has been made to study such non-recurrent levies as those imposed during the Five-Anti Campaign. Because of the nature of these impositions, it is not likely that these measures can be successfully used again in the near future.

II. URBAN TAXATION

651

In Communist China, the core of urban taxation has consisted of the business tax, the tax on business income, and the commodity taxes.

None of the trio is new in China. Under the Nationalist Government the business tax was collected as a local tax, the tax on business income was a part of the income-tax system, and the commodity tax constituted one of the main revenues of the Nationalist Government.

Under the Communist Government, all these taxes were drastically reorganized, apparently under the influence of the Russian tax system. From 1949 to date, the system of urban taxation has already undergone several important changes. Its history, which may be divided into two stages, covers the period from January 1950 to December 1952.

During the first period, the industrial and commercial tax constituted the greater part of urban taxation. The tax was a composite levy consisting

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

651 242

The agricultural tax is assessed on the basis of the gross income, taking little or no account of the cost involved in production. The system, if strictly enforced, will necessarily result in discouraging such improvements as the use of chemical fertilizers, the use of irrigation systems, etc. Chemical fertilizers have been more commonly used in many parts of Central-South China than in other parts of the country. Failure to allow for such costs of production in the tax system will necessarily mean discouragement to those who are making such improvements in their production.

651

In assessing the agricultural tax both for the regions with land reform and for the areas without land reform, the tax rates progress on the basis of the total income rather than by bracket. This could mean in some cases a payment of more tax by a taxpayer with less income than by one with more income.

IV. GOVERNMENT BONDS

652

In 1950, 100,000,000 fen (one fen or unit was worth approximately US$.75) of the Victory Bonds issued at 30 per cent or 30,000,000 fen, were allocated for subscription in Central-South China.[4] This quota is equivalent to two-thirds that of East China, and is twice as high as that of North China. This comparison seems to indicate that the burden of the government bond was relatively lower in North China than in either East or Central-South China.

V. REMITTANCES FROM ABROAD

457

One phase of the financial policy of the Chinese People's Government that has a special bearing

4. Tu-pao Shou-ts'e [Newspaper Reading Handbook], Hankow, 1950, p. 384.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

BANKING AND CURRENCY*/

I. ELIMINATION OF PRIVATE AND NATIONALIST GOVERNMENT BANKING

Hankow and Canton in Central-South China, having grown into important communications and trade centers, also became important centers for foreign and Chinese banking When the Communists set up a new banking system which stressed the "equal" distribution of banking facilities in each province, the dominant positions long enjoyed by Hankow and Canton were greatly reduced. Nevertheless, these cities still maintain comparatively important situations; the former is located at the junction of the Peking-Hankow and the Canton-Hankow railways, and is the center of the Yangtze River navigation system; the latter is China's main gateway to Hong Kong and Southeast Asia. 652

Before the promulgation of the Communist Constitution in September 1954 abolished the Greater Administrative Region of Central-South China, the People's Bank had a regional office in Hankow, and the People's Bank's Canton branch office had been able to maintain a certain autonomy. But after the People's Bank's branch offices in each provincial capital were made the highest level offices in the province, reporting only to the head office, the regional office in Hankow was terminated and Hankow is no longer an important banking center of Central-South China. Its banking position, as is that of Canton, is now ranked equally with that of other provincial capitals, although the volume of business may differ between them.

*/ Unless otherwise indicates in footnotes, statements in this chapter are based on private information of the author, Dr K. N. Chang.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652
453

In order to establish a new Communist banking system it was necessary to liquidate the old banking structure. The Communists found it easy to achieve this aim in the Central-South Region because there were only a few foreign banks in Hankow and Canton; most of the modern commercial banks in these two cities and in other interior cities were merely branches of those established in Shanghai; the native banks and a few locally registered commercial banks throughout the whole area were poorly capitalized.

When the Communists assumed authority in this area they ordered to be closed all branches of the Central Bank of China and the Farmers Bank of China two government banks established by the Nationalist Government. The branches of two banks jointly financed by government and private interests, the Bank of China and the Bank of Communications, also established before the Nationalist regime, were fitted into the new system. This was followed by the gradual elimination of the native banks and a few locally registered commercial banks. To force their liquidation, the Communists required them to increase their capital, as set forth in new banking regulations, and imposed cumbersome control measures. Most of the banks were unable to increase their capital and found it unprofitable to continue operation under the new controls. The few surviving banks in Hankow were ordered to organize a syndicate and operate jointly. As a result of the merger of all private banks in Shanghai into one Joint State-Private Bank, all of the branches of the merged banks in Central-South China were amalgamated, and the syndicated banks in Hankow were later ordered to merge with the Hankow branch of the Joint State-Private Bank. The two foreign banks, the Hong Kong and Shanghai Banking Corporation and the Banque de l'Indo-Chine, first withdrew from

Hankow and then from Canton.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

Hankow and then from Canton. 000

Two minor monetary institutions -- pawnshops and firms dealing with overseas remittances -- were treated in different ways; one monetary organization was liquidated and the other is being rigidly controlled. Most pawnshops in Central-South China, particularly those in Hankow and Canton, were small but profitable because they charged exorbitant interest rates. The larger ones were operated less successfully because of the postwar inflation. The Communists considered the pawnshops a credit mechanism which had contact with the poor masses, and took steps to drive them out of business by requiring them to increase their capital and restricting the number of objects against which loans could be made. 426 652

By the end of 1952 only a small number of pawnshops had survived; at that time the last ones were ordered closed.

There had been fifty-four firms dealing with overseas remittances in Canton. Realizing that these firms had close contact with the senders abroad and the recipients at home, and also that they had long experience in handling this kind of business, the Communists believed it necessary to keep them in operation for the purpose of securing foreign exchange. By special regulations governing firms engaged in overseas Chinese remittances, promulgated by the Communists in Canton, these firms were made agents of the government to handle overseas Chinese remittances; every transaction is under government control. 457 652

Thus the old banking structure was completely liquidated and the way was paved for the establishment of a Communist banking system.

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II. STRUCTURE OF THE PEOPLE'S BANK AND ITS SUBSIDIARIES

652

In the banking system as currently developed, the People's Bank of China is the supreme and central financial body, entrusted with the sole authority of issuing bank notes and extending credits. It has gradually built up its network of branches throughout the country with the aim of eliminating other banks, widening the circulation of People's Bank notes, and eventually extending its money and credit control to all levels.

There are five special banks which are virtually subsidiaries of the People's Bank. Entrusted with special functions in the financing of certain branches of industry and business, they are the Bank of China, the Bank of Communications, the Chinese People's Construction Bank, the Agricultural Bank of China, and the Joint State-Private Bank. In addition, there are two other financial institutions: credit co-operatives and the Chinese People's Insurance Company. The former is regarded as the basic level of banking, and the latter as a depository of long-term funds.

A. People's Bank of China

In the area of Central-South China, the regional office of the People's Bank at Hankow, under which there was a branch office in each province, had been the highest organ in charge of monetary matters and monetary administration. But the regional office ceased to function after the abolition of the Greater Administrative Region following the promulgation of the Constitution in September 1954. Now the branch office of each province is under direct control of the head office in Peking and is the highest monetary

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

body at the local level.

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There are six branch offices of the People's Bank in Central-South China, one in each provincial capital: Wuhan, Hupeh; Changsha, Hunan; Nanchang, Kiangsi; Canton, Kwangtung; Nanning, Kwangsi; and Chengchow, Honan.

The branch offices are entrusted with the following functions: [1] (1) to adjust the circulation of currency; (2) to act as agents for the state treasury; (3) to accept current accounts and promote savings; (4) to extend credits to industry and commerce, both public and private, either directly or through affiliated banks; (5) to handle clearance of bills and transfers of accounts, and facilitate remittances (6) to extend rural credits either through their own agencies or through co-operatives; (7) to look after receipts and disbursements of foreign exchange handled by affiliated banks; and (8) to handle any other monetary matters within their jurisdiction.

Each branch office has departments controlling currency, rural credit, private enterprise, foreign transactions, and also departments in charge of credit co-operatives, savings deposits, and trusts, thus covering the entire scope of banking functions.

Under each branch office there are sub-branch offices established in counties, cities, and major

1. Kuo-min Ching-chi Shih-yung Tz'u-tien [Popular Dictionary of Practical Economics], Shanghai, Ch'un-ming Press, 1953.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652

towns. Sub-branch offices in the larger cities consist of two business departments, one dealing with public organizations and the other with private individuals and firms.

At least 570 sub-branch offices are maintained at important political and communication centers in Central-South China. Some are charged with the duty of looking after a few other sub-branches and are designated as "central sub-branch offices." This organizational feature is temporary and may be discontinued when the special conditions surrounding its creation cease to exist. It is reported that there are five to nine central sub-branch offices in each province. Subordinate to the sub-branch offices are the agencies, sub-agencies, and stations in the towns and villages. In July 1951, the subordinate offices in the region were reported to total more than 3,000.

652
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In several districts in Kwangtung Province, where there are no branch offices of the Bank of China and in which are located the home towns of many overseas Chinese, stations are established for the apparent purpose of rendering service to returned overseas Chinese, but aimed mainly at assuring "repatriation" of their capital.

B. Bank of China

The Bank of China was inaugurated as a central bank in 1912 and reorganized in 1928 as a special institution for dealing with foreign trade; half its →

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652.
457

capital was owned by the government. It had branches throughout the country and 19 branches abroad. Its old status was maintained after the Communists assumed control, and directors elected by private shareholders were recognized; the general manager and directors appointed by the previous regime were replaced by Communist appointees. The director general of the People's Bank serves concurrently as the chairman of the board. As a result of this change, the Bank of China has become a virtual subsidiary of the People's Bank.

The Bank of China is charged with the following functions:[2] (1) attention to matters concerning the control of foreign exchange; (2) handling of foreign exchange, foreign securities, bills of exchange, and other commercial documents payable in foreign currency; (3) extension of credits and acceptance of deposits in connection with foreign trade; (4) supervision of accounts and the clearance of foreign trade transactions conducted through government organizations; and (5) control of overseas remittances.

The head office of the Bank of China is in Peking; its branches in China, located at places benefiting from foreign trade or overseas remittances, were reduced to twenty-two, thirteen of which are in Central-South China: Hankow in Hupeh Province; Changsha in Hunan Province; Canton, Shen-ch'uan, Chiang-men, Shih-ch'i, Chan-chiang, and T'ai-shan in Kwangtung Province, Wu-chou, Liu-chou, and Nanning in Kwangsi Province; and Hai-k'ou (Hoihow) on Hainan Island.

Kwangtung has more foreign exchange business than any other province in this area because not only

2. Ching-chi Chou-pao[Economic Weekly] , No. 31, Shanghai.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

652 457

a large part of the trade between Hong Kong and the China Mainland passes through Canton, but also a great number of former Cantonese now residing overseas regularly send money back to their families or relatives. The Hoihow branch on Hainan Island also looks after overseas remittances. Foreign exchange transactions handled by the branches in Kwangsi increased recently when railway traffic between North Indochina and China was opened.

The allegiance of the overseas branches of the Bank of China was split: those located in countries which have recognized Communist China are now subject to the control of the head office in Peking, and the rest are controlled by the head office of the Bank of China in Formosa. The former are the branches in Hong Kong, London, Singapore, Penang, Kuala Lumpur, Calcutta, Bombay, Karachi, Chittagong, Rangoon, and Djakarta, and the latter are in Saigon, Phnom Penh, Bangkok, Osaka, Tokyo, Havana, New York, and Sydney.

C. Bank of Communications

652

The Bank of Communications was chartered in 1907 to promote the development of communications; in 1928 it was reorganized as a special institution to foster and develop industries and internal trade; 60 per cent of the capital was owned by the government. The Bank of Communications was allowed to continue operations under its old status, thus receiving the same "consideration" which the Communists had given the Bank of China. The directors representing private interests were recognized, while the directors representing public interest, the chairman of the board, and the general manager were replaced

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with appointees of the new government. The bank's were redefined as follows:[3] (1) to handle government appropriations set aside for basic construction of the state, and screen and approve applications for such construction needs;(2) to organize and lead long-term investment markets; (3) to control ownership rights for public shares of enterprises operated by state- private joint interests; and (4) to handle long-term credits.

The handling of appropriations for basic construction was later transferred to the newly established Chinese People's Construction Bank. The organization of long-term investment markets has been virtually impossible as private capitalists were nearly entirely liquidated. The only function of the Bank of Communications is to handle long-term credits to jointly managed state-private enterprises, the funds being supplies by the People's Bank. The Bank of Communications has, therefore, in fact become an industrial financing department of the People's Bank.

The Bank of Communications has its head office in Peking and branches at places where there is modern industry. Those important ones in Central-South China are: Hankow, Wuchang, Hanyang, Shashih, I-ch'ang, Huang-shih in Hupeh Province; Changsha, Hsiang-t'an, Heng-yang in Hunan Province; Chengchow, Kaifeng, Hsin-hsiang, Anyang in Honan Province; Nanchang, Chiu-chiang, Ching-te-chen, Kan-hsien, P'ing-hsiang in Kiangsi Province; Canton, Swatow, Shao-kuan in Kwangtung Province; and Wu-chou, Kweilin, Liu-chou in Kwangsi Province.

D. Chinese People's Construction Bank

3. Cheng Chu-yuan, Monetary Affairs of Communist China. Hong Kong, Union Research Institute, 1954, p. 25.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

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In order to step up progress of state-planned basic construction and to enforce supervision over the use of funds appropriated for such purposes, the Chinese People's Construction Bank was established on October 5, 1954, and entrusted with the following specific functions:[4] (1) to look after the funds of basic construction projects, either provided by appropriations fro m the budget or raised by the projects themselves; (2) to supply short term credits to the contracting organizations undertaking work for projects according to the government's credit plan; (3) to settle accounts and make returns in connection with the government's appropriations for the projects; and (4) to supervise the use of funds appropriated or raised, the arrangement of payment between the projects and contracting organizations, and matters related to finance, cost accounting and investment of the projects.

Although this bank is nominally under the control of the Ministry of Finance, it is in effect another subsidiary of the People's Bank: it receives government appropriations from the People's Bank with which to credit the account of each project; and it draws on the People's Bank for short term credits to other projects in accordance with the government's credit plan. Hence it has no individual discretion over its operations. Its head office is in Peking, and branches are at places where there is state industry or basic construction. Nearly all branches use as their office parts of the buildings of the Bank of Communications or People's Bank. In Central-South China the list of its branches is almost identical with that of the Bank of Communications.

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4. New China News Agency Release, Peking, September 13, 1954.

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E. Agricultural Bank of China

652

The Agricultural Bank of China, set up on March 25, 1955,[5] is placed under the direction of the People's Bank to carry out the following functions: (1) to extend long term and short term credits to state-private operated agricultural, stock-raising, fishery, and producer mutual aid and co-operative organizations as well as individual producers; (2) to handle capital investments allocated in the state budget for agriculture, forestry, and water conservation; (3) to guide the people's credit co-operative organization; and (4) to provide savings deposit services for rural residents, producer mutual aid and co-operative organizations, collective farms, and state agriculture and water conservation projects.

Officially, the function of handling capital investments appropriated in the budget is temporarily to be conducted by the Chinese People's Construction Bank. It seems that the main function of the Agricultural Bank will be to promote and supervise credit co-operatives and to see that the extension of rural credits is soundly conducted. Accordingly, the function of supervising credit co-operatives, formerly handled by the People's Bank Branch offices, will be turned over to the branch offices of the Agricultural Bank of China.

The first thing done by the Agricultural Bank after it began operations was to grant loans to poor farmers for the purpose of paying their subscriptions in credit co-operatives. This was done allegedly to raise the living standards of the poor farmers.

5. Ibid., March 25, 1955.

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F. Joint State-Private Bank

652
453

When the merger of private banks took place in December 1952, the locally chartered small private banks in Hankow and Canton and other cities and the local branches of small banks had all been closed down. The only ones still in operation were branches of the big private banks in Shanghai: eleven in Hankow, eight in Canton, and smaller numbers in other important cities. Following the merger, all branch banks in Hankow, Canton, and Changsha were amalgamated into one unit as branch offices of the Joint State-Private Bank; branch banks in other cities were ordered to close.

The functions of the Joint State-Private Bank are as follows: (1) to handle accounts of private enterprises; (2) to extend short term credits to private enterprises, subject to the advice of the People's Bank; (3) to handle overseas Chinese' remittances through the branches of component banks still operating in Hong Kong for the account of the Bank of China and to handle inland remittances; and (4) to accept savings deposits for the account of the People's Bank.

The way amalgamation was conducted in Hankow furnishes an example of the relentless attitude taken by the Communists towards private banks, and of the pitiful position in which this jointly operated bank has been placed. The assistant manager of the Hankow branch of the People's Bank was appointed to serve concurrently as manager of the business department of the Joint State-Private Bank, assisted by four assistant managers appointed from the staff of the former private banks. Each component bank

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

conducts its former business at a single counter, identified with the name of the former bank; only 40 per cent of the old staff were re-employed, and the important positions were given to new employees sent from the People's Bank or to the so-called activists. 652 453

It is evident that this bank is only a department of the People's Bank, created to deal with private enterprises, and will be dissolved when most of the industry has been converted to joint enterprises and when private commerce will have been full exterminated.

G. Credit Co-operatives

At the bottom of the Communist banking pyramid are the credit co-operatives. Their establishment and operation, at earlier stages, seemed to have the welfare of the peasants in mind; rural credit was to be extended through co-operatives. Now emphasis has shifted, and the Communists try to attract peasants' savings deposits and utilize them to subsidize those in need. Moreover, the government is now attempting to contract its note issue, increased by government purchases of grain and cotton, by forcing farmers to deposit the proceeds of their sales with credit co-operatives. 452 474

There are three types of credit co-operatives: (1) credit co-operatives, the highest level of co-operative organization, having members and directors; their financial resources consist of members' capital and deposits; (2) credit departments, attached to supply and marketing co-operatives which have neither members nor independent capital and which

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456

The Chinese People's Insurance Company is considered by the Communists as a means of accumulating long-term funds. The China Insurance Company, a subsidiary of the Bank of China, has overseas branches in places where there are branches of the Bank of China. Branches located in countries which have recognized the government of Communist China are allowed to continue operations in order to generate foreign exchange; the head office in Shanghai is merely a controlling office; there are no branches in China proper.

652

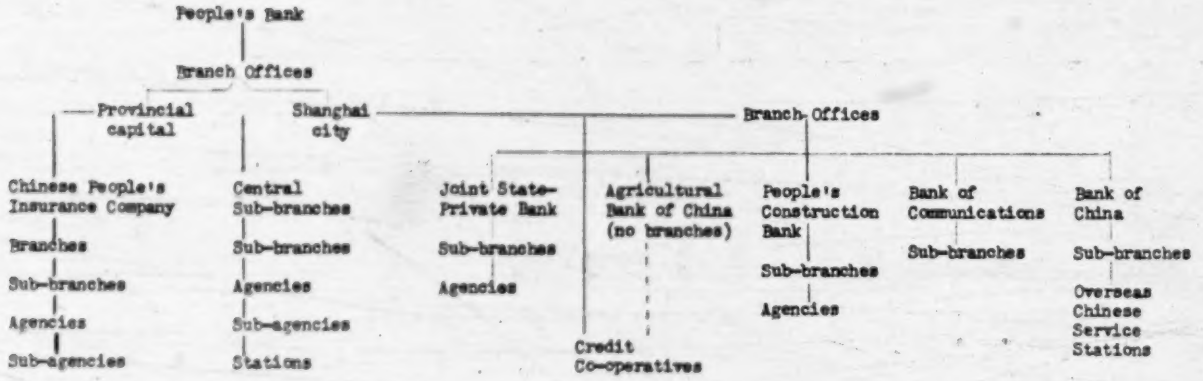
The banking system in Central-South China may be summarized in the chart which follows:

[See following page for chart.]

Stanford U. S-4,5 1956 AF14 Central China AF14

652

BANKING SYSTEM IN CENTRAL-SOUTH CHINA



(Chart faces p. 743.)

(Chart faces p. 743.)

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

III. BANKING OPERATION

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Although there are several special banks in the Communist banking system, they are merely arms and limbs of the People's Bank of China from which policy and resources spring. All banks operate as one body.

The operations of all banks are designed to draw cash funds from the hands of individuals, firms, and organizations, and to control all credits In this way the use of cash will be minimized, all receipts and payments will be handled through bank accounts, and the People's Bank will, in fact, become a central clearing house for the national economy.

A. Cash Control

All public organizations and enterprises must deposit all their cash holdings, excepting small sums as permitted by the authorities, in the local offices or agencies of the People's Bank; all payments, excepting salaries and wages and purchases of products in rural areas, must be made by check. All persons engaged in business must deposit the net balance of each day's proceeds from transactions into their accounts in the bank and must meet their purchases with checks. Under no circumstances may cash be used. All persons in possession of cash exceeding PB$2 million (about US$80) must deposit their holdings in the banks.[7]

A differential annual interest rate, announced

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7. Cheng Chu-yüan, op. cit., p. 84.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

in January 1954, is paid on deposits;[8] to state enterprises, 2.52 per cent; to joint state-private enterprises, 3.24-7.2 per cent; to private enterprises for current deposits, 5.10-5.40 per cent; and for time deposits, 9.0-14.4 per cent. 652 453

In order to attract scattered funds held by individuals and prevent them from holding cash beyond the fixed limit, the People's Bank, in addition to sub-branches and agencies, has savings receiving and paying stations in residential quarters of each city. Officers of these stations visit residents frequently to collect their savings. In villages, People's Bank's agencies invite local leaders to organize savings promotion committees to do the work of propaganda and persuasion. By such means most families are forced to open savings accounts with banks. High interest rates of 5 per cent to 5.4 per cent for current savings deposits and 9 per cent to 14.4 per cent for fixed savings deposits are paid.[9] 652 454

Bank deposits in Central-South China used to rank last, having totaled only one-sixth of those deposited in East China. This was not only because of the lack of banking facilities, but also because the people of Kwangtung, the richest province in this area, preferred to hold banknotes issued by the foreign banks in Hong Kong rather than to deposit their funds in Chinese banks. Although the Communists boast that as a result of their promotion of savings deposits one out of every six persons in Canton now has a savings bank account, the amount of total

8. Jen-min Jih-pao [People's Daily], Peking, January 1954.

9. Chung-kuo Ching-chi Nien-pao [China Economic Annual], No. 1, Tokyo, China Research Institute, 1952.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14 652 ●

savings deposits in Central South is not available. 454

The Communists regard overseas remittances to families of overseas Chinese in Kwangtung as an important source of deposits. Each family receiving remittances has to open a bank account, and always find drawing on it difficult. This has resulted in a decrease of remittances. 652 457

The government has attempted to attract to the bank the plentiful funds received in lump sums by peasants after they sell their harvest of grain and cotton to the government monopoly. The bait for deposits in the banks or credit co-operatives is a very high interest rate; it is 14.4 per cent for deposits under three months and 18 per cent for those of more than three months. But after the winter of 1954, only in Kiangsi Province did the deposits reach 30 per cent of the purchase proceeds; they were only 5 per cent in Honan Province, and much less in Hunan, Kwangtung, and Kwangsi.[10] Some peasants were afraid to expose their cash receipts, and others prefer to hoard commodities. 652 454

Different forms of bank transfers of funds within one city or between two different places are available. The limit of cash a person may legally carry when travelling is limited to PB$1 million, old currency (about US$40).[11] 652 453

10. Ta-kung Pao [Ta-kung Daily], Tientsin January 3, 1955.

11. Cheng Chu-yüan, op. cit., p. 84.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

B. Credit Control

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As the Communist banking system developed, the People's Bank has become the only source of bank credit. Branches of the People's Bank are authorized to extend short-term credits to state enterprises, production units attached to armed forces, and co-operatives and private enterprises at places where there is no Joint State-Private Bank. State enterprises and public organizations short of working capital can apply for short-term (one year) credits provided the bank approves their financial statement and plan of repayment. Large private industries which are considered beneficial for the national economy, have promise of further development and, having deposited all their funds in the bank, can obtain a continuing supply of credits under a production and financial plan approved by the bank. Smaller private industrial and commercial enterprises can apply for a fixed amount of credit on condition that they have accounts with the bank and disclose their financial condition to the bank. Any credits must be used for the purpose defined in the application.

The bank's interest rate policy follows the principle of "cheaper for public than for private enterprise," and, "cheaper for industrial than for commercial enterprise." Annual interest rates for loans announced in March of 1955, are 5.58 per cent for public industry, 8.28 per cent for public commerce, 10.80-19.80 per cent for private industry, and 16.20-23.40 per cent for private commerce.

Aiming to eliminate non-bank credit, which provides a way of bypassing the bank's control, the

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

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government had prohibited public enterprises to purchase on credit. But, in view of the general failure to observe this prohibition, a conference was recently convened to discuss ways of completely eliminating purchases on credit between all public organizations.[12] The conference is to reaffirm the government's determination on this subject.

According to Communist policy, capital investments should be provided by the government in budget appropriations; therefore, no banking funds are to be used for long-term credit.

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Rural credit funds were almost entirely provided by the People's Bank; the extension of credit was mostly made through the credit co-operatives. Loans were to be repaid with the proceeds of compulsory sales of grain and cotton, which the peasants were forced to deposit with the co-operatives. The co-operatives have been able to attract few deposits besides these proceeds.

The amount of credit extended by the co-operatives was extremely small. For example, Communist newspapers report that 9,000 co-operatives in Hunan Province granted PB$49 million of credit in June 1954, averaging 5.5. million (US$220.) from each co-operative. One village in Hupeh Province, having suffered a flood in mid-1954, obtained PB$ 21 million from 3 co-operatives for 183 farm households, averaging PB$7 million (US$280.) granted by each co-operative and PB$114,000 (US$4.56)[13]

12. Ta-kung Daily, Tientsin, May 7, 1955.

13. These figures are in the pre-March 1955 old currency. See People's Daily, Peking, Jul. 13, 1954.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

for each farm household. Such amounts are too trifling to relieve the Chinese peasants who are constantly in seasonal financial difficulties, quite aside from the need for funds for increasing production.

IV. CURRENCY

A. Currency System

Notes of the People's Bank of China, first introduced in December 1948 in North China, were put in circulation throughout Central-South China following the Communist victory and the establishment of local People's Bank offices. This paper currency has become the only legal tender throughout the whole country. It was issued at first in denominations of 1, 5, 10, 50 and 100 dollars. By the second half of 1949, currency inflation made it necessary to issue notes of larger denominations of 500 and 1,000 dollars; this was followed by the 10,000 denomination note at the end of 1949, and the 50,000 denomination note at the beginning of 1954.

On February 21, 1955, a government order announced that starting on March 1 new People's Bank notes in denominations of one yuan, 2, 3, 5, and 10 yuan, one chiao (ten cents), five chiao, one fen (cent), two and five fen would be issued, and that the old People's Bank notes would be called in at the rate of 10,000 to 1.[14] After April 1, only small denomination notes of 5,000 and less of the old issue might continue to be used. It was also announced by the People's Bank that 10 yuan notes would not be issued for the time being.

14. Photo samples of some of the new notes are appended at the end of chapter. New China News Agency Release, Peking, February 21, 1955.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

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The Communists hailed their currency as one of the most stable in the world. Its stability is not secured by a gold reserve, but is fully backed by the balanced position of fiscal receipts and expenditures, the balanced position of distribution of supplies and the balanced position of cash receipts and payments. This means, when translated into the language of a capitalist economy: the stability of the currency is secured by excess impositions, controlled distrubiton of supplies, forced concentration of cash funds in the government banks, and exports made possible by general starvation.

One of the most serious obstacles to currency unification in Central-South China, and also to the stabilization of the currency, had been the circulation of large amounts of Hong Kong paper currency issued by British banks. The volume was estimated to be more than half of their total issue, amounting to HK$ 900 million (about US$150 million) at the time the Communists took over Canton. On February 3, 1950, the Communists in Canton prohibited further circulation of Hong Kong and other foreign currencies, and ordered their exchange for People's Bank notes at the rate quoted by the Bank of China.[15] Propaganda and coercion were used so successfully to back up the order that Hong Kong notes had almost disappeared from the market by the end of 1950, although a small amount may still be kept hidden.

Silver dollars had circulated freely in Hankow and other interior cities when the Nationalist currency collapsed. Since they were only allowed to be

15. New China Events Quarterly, No. 1 1950, p. 72.

kept but not used in transactions, most of them were surrendered to the People's Bank in exchange for bank notes. Although some may still be hoarded, they will not have much effect on the stabilization of People's Bank currency. 436 652

The disappearance of Hong Kong currency and silver dollars from the market does not mean that the people have confidence in the Communist currency. The former were simply driven out by force. On the contrary, the continued preference among Cantonese for Hong Kong currency has been amply proved by the black market rate of People's Bank notes in Hong Kong. Before the issue of the new notes, big denominations were quoted at HK$1.48 per PB$10,000 on January 17-21, 1955, against the official rate of HK$2.34; this is a discount of 37 per cent. The black market rate of People's Bank notes rose to HK$1.85 per Yuan on July 11-16, 1955, because of the contraction of cash notes through the exchange of the old notes for the new ones. Needless to say, the people in the interior still treasure silver dollars if they are given freedom of choice.

B. Currency Control

At the time of issue of the new currency, the Communist authority boasted of the stability of People's Bank notes as proved by the fact that there had been no change in commodity prices at the time of currency conversion in March 1955 when they were required to be quoted in terms of the new currency, and that retail prices in Hankow even 652 435

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

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dropped by 0.83 point from the index before the issue of new currency.[16] True, the price level had been stabilized since March 1950, but this was attained by the control of commodities and, in particular, by currency control. Thus the inflationary trend of the Communist currency was concealed.

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Control of the currency has been effected by control over cash through the banking mechanism, as mentioned in the discussion of the banking system, and by the withdrawal of currency from circulation through frequent impositions. The impositions began with an issue of Victory Bonds in 1950, amounting to US$ 70 million, 30 per cent of which was allocated to Central-South China.[17] This was followed by the ammunition contribution for the Korean war made by this area in 1951, which was more than 21 per cent of the total amount of US$ 220 million.[18] During the Nationalist regime, the savings of the people in Central-South China had been relatively the smallest, as indicated by bank deposit statistics. When the Communists attempted to squeeze out people's savings by imposing penalities during the so-called Three-Anti and Five-Anti campaigns, currency held by the people had been so scanty that the People's Bank advertised in newspapers, stating it was prepared to accept silver or silver dollars. The Economic Reconstruction Loan of 1954-55 was mainly aimed at absorbing the savings held by the poorer people; the scarcity of savings was attested by the fact that workers' subscriptions were allowed to be deducted from their wages over a period of from three to ten months.

16. New China News Agency Release, Peking, March 1, 1955.

17. New China Events Quarterly, No. 4, 1949, p. 127.

18. Ho Yü-wen, Chung-kung Ts'ai-cheng Chieh-p'ou [An Analysis of Communist China's Finance], Hong Kong. Asia Press, 1953, p. 74.

1:Stanford U. S-4, 5 1956 AF14 Central China AF14

The above measures resulted in the drainage of all available funds to the government; but by doing so, these measures reduced the people's purchasing power, a heavy price indeed for the stabilization of Communist currency.